(24)

No. 90-1029

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

EASTMAN KODAK COMPANY,
Petitioner,

v.

IMAGE TECHNICAL SERVICES, INC.; J-E-S-P CO., INC.; SHIELDS BUSINESS MACHINES, INC.; MICROGRAPHIC SERVICES, INC.; MICRO MAINTENANCE, INC.; ATLANTA GENERAL MICROFILM CO., INC.; ROGER KATONA, D/B/A G. & S. ELECTRONICS; AMTECH EQUIPMENT MAINTENANCE, INC.; ADVANCED SYSTEMS SERVICES, INC.; B.C.S. TECHNICAL SERVICES, INC.; BOB INGLE, INC.; DATA PROX EQUIPMENT CO.; FISHER MICROGRAPHICS, INC.; I.O.A. DATA CORP.; SEARLE ENTERPRISES, D/B/A MICRO IMAGE, INC.; MIDWEST MICROFILM EQUIPMENT & SERVICE, INC.; OMNI MICROGRAPHIC SERVICES, INC.; and CPO, LTD.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY, ALLSTATE INSURANCE COMPANY, NATIONWIDE INSURANCE, GOVERNMENT EMPLOYEES INSURANCE COMPANY, UNITED SERVICES AUTOMOBILE ASSOCIATION, ALLIANCE OF AMERICAN INSURERS AND NATIONAL ASSOCIATION OF INDEPENDENT INSURERS, AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

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INTEREST OF THE AMICI CURIAE

State Farm Mutual Automobile Insurance Company, Allstate Insurance Company, Nationwide Insurance, Government Employees Insurance Company, United Services Automobile Association, Alliance of American Insuers and National Association of Independent Insurers (the "insurance company amici") are among (or represent) the nation's principal automobile insurers. Together, the constituent companies insure approximately 100 million American motorists. Their concern is over the potential impact of the rule of law proposed by the petitioner and its amici: A manufacturer facing vigorous competition in the sale of equipment conclusively lacks the power to take significantly anticompetitive action in the related aftermarkets. Because of their long familiarity with the automobile industry, the insurance company amici can be of assistance to the Court by demonstrating that the premise of petitioner's argument does not hold true for important aspects of that industry.[1]

The interest of the insurance company amici relates particularly to the repair of crash-damaged automobiles and the vast parts and service markets that have grown to provide these repairs. There is a $9 billion annual "crash parts" market.[2] For decades, virtually all of those parts were available only from the original automobile equipment manufacturer. Recently, a competitive market

[1] The parties' letters of consent have been filed with the Clerk pursuant to Supreme Court Rule 37.3.

[2] Crash parts are metal, plastic and glass components, such as bumpers, fenders, hoods and windshields that are commonly used in the repair of crash-damaged vehicles. They do not include "hard parts," which are functional components such as spark plugs, mufflers, batteries and thousands of others used in the repair and periodic maintenance of the vehicles. The amicus brief of the Independent Auto Aftermarket Association discusses the anticompetitive impact of petitioner's proposed rule on the hard parts industry.

has emerged for some parts, with the result that prices for these parts have plummeted and overall crash parts price indices have fallen significantly.

The rule advanced by the petitioner and its amici would license automobile manufacturers to engage in anticompetitive activities in the aftermarket that can have profound and devastating consequences in this crash repair market. Automobile manufacturers could use their power over those crash parts for which they are the sole source to foreclose the developing competition from independent crash parts manufacturers. That competition now results in savings to insurers and policyholders in the range of $400 million annually.

SUMMARY OF ARGUMENT

This case nominally involves the issue whether respondents offered sufficient evidence to counter petitioner's motion for summary judgment. While we believe that respondents' evidence sufficed to raise genuine issues of fact precluding summary judgment,[3] we assume that respondents' brief will address that issue in detail. The insurance company amici are concerned over the effort by petitioner and the Solicitor General, echoed by the supporting amicus brief of the Motor Vehicle Manufacturers Association ("MVMA"), to have this Court remove all antitrust constraints upon manufacturers' tactics in aftermarkets so long as they face strong competition in the underlying original equipment markets.

Petitioner argues that consumers' equipment purchasing decisions will discipline any manufacturer that charges supracompetitive prices in the aftermarket for

[3] Of particular significance, in our view, was the evidence that petitioner did in fact charge supracompetitive prices for lower quality service. Joint Appendix at 91, 341, 414, 469, 493, *Eastman Kodak Co.* v. *Image Technical Servs., Inc.*, No. 90-1029 ("J.A.") and the evidence that petitioner's policies were aimed at eliminating the competition provided by independent service organizations. *See infra* p. 13.

supplies, repair parts and services. That argument may make sense in markets approaching the theoretical free market model—homogeneous products, informed consumers, no transaction costs for switching from one competitor to another and no opportunities for price discrimination. There is no basis, however, for asserting that the same is universally true in the real world, no matter how radically any particular industry's characteristics depart from those of the model. For example, there are industries in which equipment consumers cannot accurately predict lifetime equipment costs or lack sufficient incentive to switch to other equipment vendors. There are other industries in which competing original equipment sellers similarly tie in downstream parts, supplies and repairs or where an insurer rather than the equipment owner bears the costs of such products or services. In all such cases, the competition for original equipment sales fails to prevent a manufacturer's anticompetitive conduct in the parts and service aftermarkets.

Adoption of petitioner's argument carries this danger with respect to the automotive industry: MVMA's automobile manufacturer members will see such a ruling as lifting the legal restraints that prevent them from driving independent manufacturers of crash parts out of business. Automobile manufacturers could accomplish this through their control over the vast majority of repair parts that repair shops must have in order to repair crash-damaged cars. Each of the automobile manufacturers could decide to confine such parts to those repair shops that agree to use only the manufacturer's crash parts when repairing its cars.

Consumer automobile purchasing decisions will not prevent that from happening. The aftermarket crash repair aspect of the automotive industry differs in critical ways from the theoretical free market model because it is unlikely that car buyers will know or have an incentive to react to the manufacturer's elimination of competing crash parts. The car buyer cannot predict accidents,

much less whether it will be the buyer's fault or that of another party who will pay for the repairs, how extensively the car might be damaged, or whether the parts that will have to be replaced could previously have been secured at lower cost from independent manufacturers. The car buyer does know, however, that insurance will cover all or some of the costs. Thus, action by the automobile manufacturer to eliminate independent crash parts will most directly harm the insurance companies and independent crash parts manufacturers—none of which controls the car buyer's decision on which car to buy. Clearly, then, in contrast with petitioner's model of perfect competition, interbrand competition in the automobile industry can play no significant role in deterring the automobile manufacturers from foreclosing independent crash parts manufacturers from the market.

The insurance company amici estimate that the loss of the competition provided by independent crash parts manufacturers would cost in the range of $400 million annually. That is reason enough for the Court to decline the invitation of petitioner and its amici to draw overbroad conclusions from the state of interbrand equipment competition.

ARGUMENT

I. PETITIONER IS REALLY ASKING THIS COURT TO REMOVE ALL ANTITRUST LAW CONSTRAINTS ON AFTERMARKET ACTIVITIES OF MANUFACTURERS THAT LACK POWER IN ORIGINAL EQUIPMENT MARKETS

Petitioner takes the position that "[i]f Kodak does not have market power in the upstream [*i.e.*, sale of the original equipment] markets, it does not matter what other markets it is trying to monopolize." J.A. at 688.[4] The

[4] The MVMA argues "for reversal of the decision below because of the serious adverse consequences of a holding that a manufacturer without market power over the goods it sells can have market power over the replacement parts for those goods." Motor Vehicle Manu-

Solicitor General seemingly frames the proposal in a more benign way: "summary judgment should be granted [in such cases as this] in the absence of evidence showing that the [manufacturer], despite its lack of power in the equipment markets, nevertheless exercises power in the aftermarkets for its equipment." Solicitor General's Brief at 16, *Eastman Kodak Co.* v. *Image Technical Servs., Inc.*, No. 90-1029 ("S.G. Br."). It quickly turns out, however, that the Solicitor General finds it inconceivable that such evidence could exist. *Id.* at 16 n.13.

Thus, in substance, the petitioner and its amici seek a ruling that is both novel and sweeping: manufacturers lacking power in original equipment markets must be conclusively presumed to lack power to effect significant anticompetitive restraints in aftermarkets. Their argument is that any supracompetitive pricing in aftermarkets by companies lacking power in equipment markets must be self-defeating because those companies would lose original equipment sales. On this basis, they ask the Court to conclude that no antitrust cause of action lies for activities in aftermarkets by firms that lack power in the related original equipment markets—whether the charge is monopolization, attempted monopolization, or tying, and whether on a per se or unreasonable restraint of trade theory.[5] The insulation of such activities is not

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facturers Association Brief at 1, *Eastman Kodak Co.* v. *Image Technical Servs., Inc.*, No. 90-1029 ("MVMA Br."). The adverse consequences are that the industry would be subject to allegedly vexatious litigation. *Id.* at 4.

[5] We assume, *arguendo*, that Kodak's equipment market share is insufficient to create liability for tying purposes, though the record suggests room for doubt on that score. *See infra* notes 6, 12. In any case, the proposed rule, based as it is on a conclusion that the manufacturer's lack of power in the equipment market is dispositive of any issue concerning anticompetitive aftermarkets, seems particularly inappropriate under a rule of reason analysis. The Court said in *Jefferson Parish Hospital District No. 2* v. *Hyde* that an antitrust violation could be established based on an analysis of competitive effects even when "the seller does not have either the

justified by petitioner's perfect market model and would lead to disastrous consequences in the automobile crash-repair market.

II. A LACK OF MARKET POWER OVER ORIGINAL EQUIPMENT SALES DOES NOT NECESSARILY PRECLUDE SIGNIFICANT ANTICOMPETITIVE CONDUCT IN AFTERMARKETS

It is one thing to say that a manufacturer's 20% market share in the original equipment market precludes a holding that its tying of one aftermarket to another is unlawful per se.[6] It is quite another to say that if the manufacturer has only a 20% market share at the equipment level, any tying, exclusive dealing or attempted monopolization of aftermarkets is in effect *lawful per se*.

We do not say that petitioner's underlying economic theory can never make sense. Perhaps there are certain circumstances approaching ideal market conditions in which competition for sales of original equipment may indeed constrain the manufacturer's aftermarket behavior. Such situations might well warrant requiring plaintiff to demonstrate that significant anticompetitive aftermarket conduct by equipment manufacturers is possible despite the existence of vigorous competition for original equipment sales. It goes too far, however, to presume con-

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degree or the kind of market power that enables him to force customers to purchase a second, unwanted product in order to obtain the tying product." 466 U.S. 2, 17-18 (1984); *see also Smith Mach. Co.* v. *Hesston Corp.*, 878 F.2d 1290, 1298 (10th Cir. 1989), *cert. denied*, 110 S. Ct. 1119 (1990).

[6] The court below found that "Kodak's share of the interbrand copier and micrographic equipment markets varies and may approach as much as twenty-three percent." *Image Technical Servs., Inc.* v. *Eastman Kodak Co.*, 903 F.2d 612, 618 (9th Cir. 1990), *cert. granted*, 111 S. Ct. 2823 (June 17, 1991) (No. 90-2029). We understand, however, that in respondents' view, Kodak's share of some of the relevant markets involved was considerably higher.

clusively that no such proof is possible, even where there are significant deviations from the perfect market model. That would surely not be justified with respect to important aspects of the automobile industry, the largest industry in the country.

We next discuss some of the factors which, if present, make it highly unlikely that new equipment sales competition has the requisite deterrent effect. In the succeeding section, we apply the relevant factors to the automobile repair industry.

A. *Lack of Customer Awareness.* A key link in the petitioner's chain of reasoning is that new equipment customers will know of any exploitation of old customers by the manufacturer in the relevant parts and service aftermarkets that significantly increases overall life cycle costs for the equipment above competitive levels. Indeed, petitioner relies heavily on its assertion (controverted by respondents) that Kodak customers take aftermarket prices into account in making their decisions on original equipment purchases. Petitioner's Brief at 12, *Eastman Kodak Co.* v. *Image Technical Servs., Inc.*, No. 90-1029 ("Pet. Br."). In like manner, the Solicitor General concedes (at least at first) that consumer awareness, at the time of purchase of the original equipment, of what the manufacturer does in the aftermarket is a *sine qua non* for the presumed disciplinary effect to occur. S.G. Br. at 16 n.13.[7]

In any case, the logic of petitioner's argument requires that prospective new customers be aware of the parts and

[7] Later in its brief, however, the Solicitor General asserts that customer awareness is irrelevant because competition for new sales would prevent supracompettive pricing in aftermarkets. S.G. Br. at 19 n.18. This is assertedly because the manufacturer would lose not only the new sales but also all the aftermarket profits on those new sales. That argument, however, also requires that the customers have knowledge of, and an economic incentive to react to, the manufacturer's aftermarket prices.

service costs imposed by the manufacturer on those who already own its equipment. Otherwise, the manufacturer has little reason to fear that what it does in the aftermarket will cause loss of new equipment sales to competitors.[8] While there may be examples of industries in which consumers will have such knowledge, because competitors will have an interest in informing them, we see no basis for conclusively presuming such knowledge in every case. Particularly in the case of complex equipment, manufacturers may be able to delay disclosure or hide the fact that they have increased service prices—perhaps by gradually lowering the level of and quality of service. Service costs for complex machinery are particularly difficult to compare because the services are so heterogeneous and are spread out over a long period of time. Evidence that consumers would not have sufficient information at the time of initial equipment purchase to predict high aftermarket costs is therefore unquestionably relevant in any case in which, like here, it is argued that competition for original equipment sales precludes a rational manufacturer from engaging in anticompetitive behavior in aftermarkets.[9]

[8] *See* Howard Beales, Richard Craswell & Steven C. Salop, *The Efficient Regulation of Consumer Information*, 24 J.L. & Econ. 491, 510 (1981). *See generally* Richard Craswell, *Tying Requirements in Competitive Markets: The Consumer Protection Issues*, 62 B.U. L. Rev. 661 (1982); George J. Stigler, *The Economics of Information*, 695 J. Pol. Econ. 213 (1961); Tibor Scitovsky, *Ignorance as a Source of Monopoly Power*, 40 Am. Econ. Rev. 48 (1950).

[9] Petitioner and the Solicitor General suggest, in effect, that the Court need not be concerned over tying arrangements because the public benefits when equipment manufacturers are permitted to package equipment, supplies, parts, and repair services and to compete on the basis of the cost of the packages over the life cycles of their equipment. Pet. Br. at 4 & S.G. Br. at 14. The benefits are not so clear. Equipment manufacturers with so much more information on which to make life cycle cost predictions have substantial bargaining advantages over consumers who lack relevant experience. Those advantages are reduced if consumers can buy the items separately, because the consumers are then in a position to

B. *Similar Practices by Competitors.* Evidence of competitors' practices in aftermarkets may also suffice to preclude summary judgment premised on a defendant's lack of market power over original equipment sales. This Court has consistently held that the lawfulness of a company's exclusive dealing or tying arrangements turns in part on whether significant parts of the market are subject to similar restraints by the company's competitors. *Standard Oil Co.* v. *United States*, 337 U.S. 293, 309 (1949); *Jefferson Parish Hosp.*, 466 U.S. at 12; *see also Rosebrough Monument Co.* v. *Memorial Park Cemetery Ass'n*, 666 F.2d 1130, 1143 (8th Cir. 1981) (finding the existence of sufficient market power partly because the tying arrangement was "uniformly followed by nearly all of the" defendant's competitors), *cert. denied*, 457 U.S. 1111 (1982).

Taking account of competitors' practices makes good sense here. An oligopolistic manufacturer would have little reason to fear that exploiting existing customers on prices of service and parts will cause a loss of new equipment sales if the offerings of its competitors are not more favorable.[10]

Accordingly, there can be no escape from the conclusion that evidence of competitors' sales and aftermarket policies is also quite relevant in determining whether competition for new sales precludes a manufacturer from

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make precise price comparisons for each of the items separately and to make those comparisons at the actual times of purchases. Such consumers, by reason of their being better informed and able to bargain more effectively, are likely to be able to reduce their total ownership and operating costs for the lifetime of the equipment.

[10] It may be, of course, that one or more competitors in an oligopoly may see an opportunity to gain new sales by breaking ranks. It may also be, however, that a potential renegade may perceive that others will follow suit, which would quickly cancel any gains it might receive and leave everyone worse off. Accordingly, each might well decide that it is in its long-term interest to resist the temptation to break ranks. Were it otherwise, there would be no need for antitrust concern over cartels and oligopolies.

engaging in significantly anticompetitive aftermarket tying and other exclusionary practices. Summary judgment for the manufacturer based purely on its share of the equipment market—without affording plaintiff any opportunity to demonstrate that its competitors follow similar aftermarket policies—would be inappropriate.

C. *Product Differentiation.* The fact that a manufacturer's market share is in the 20% range does not preclude the possibility that it may exact leverage with respect to a significant number of customers for whom, for one reason or another, other equipment is not readily substitutable.[11] For example, much of the new business may come from existing customers who must add to their existing equipment or replace some units. These customers may be "locked in" to a particular manufacturer's equipment because of the economic penalties they would have to bear to switch to another manufacturer's equipment. *See, e.g.*, J.A. at 424-25, 467, 487-88. Such customers may to some extent be protected by the manufacturer's need to compete for the business of the other customers, *see* Pet. Br. at 23-24 n.9, but it is a question of degree, depending on the size of the one group compared with the other, and depending also on the seller's ability to price discriminate. There may thus be cases in which the profits to be derived from sales of high-priced aftermarket parts and service to those for whom other products are not a ready substitute more than make up for the lost profits the manufacturer would have secured from new sales to others.[12] This calculation is of course unnecessary if the

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[11] *See, e.g.*, F. M. Scherer & David Ross, *Industrial Market Structure and Economic Performance* 16-17 (3d ed. 1990).

[12] Such may be the case here. Petitioner's claim that customers do take into account total costs, including those that occur in its aftermarkets, has to be considered along with the finding by the court below that—viewing the facts most favorably to the respondent—petitioner in fact charged supracompetitive prices for lower quality service. *Image Technical Servs.*, 903 F.2d at 614. These two

manufacturer can charge the "locked-in" customer higher prices.[13]

Petitioner dismisses such evidence on the ground that Kodak could not maltreat old customers without driving new customers into the arms of competitors. It may be, however, that customers are unaware of lower-priced alternatives. Furthermore, petitioner's argument fails to account for the possibility that the customer needing to expand its Kodak equipment or replace one or more units would lack an incentive to turn to other manufacturers because the supracompetitive aftermarket prices, troublesome though they might be, would be small compared with the costs of replacing the original equipment.

Whether such considerations in fact apply in this case, they surely are possibilities in other cases.[14] Accordingly,

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propositions, taken together, suggest that petitioner may indeed have appreciable market power in the equipment market. Indeed, the record indicates that Kodak's charge for a maintenance contract on one of its copier machines was three times that of Xerox, its largest competitor on an equivalent machine. J.A. at 341. Perhaps trial would show that there is some other explanation—*e.g.*, that Kodak charges sufficiently less for its equipment so that the total life cycle costs, including equipment, parts and service, are about the same as those of competitors. As the record now stands, however, Kodak may well have believed that the profits to be made in the aftermarket were worth the predicted loss of original equipment sales. If so, Kodak's own analysis must have been that it had sufficient market power to engage in supracompetitive pricing in the aftermarket.

[13] Steven C. Salop & Joseph E. Stiglitz, *Bargains and Rip-Offs: A Model of Monopolistically Competitive Price Dispersion*, 44 Rev. of Econ. Stud. 493 (1977).

[14] The above considerations also show that the reliance of petitioner and amici on the "economic implausibility" rule of *Matsushita Electric Industrial Co.* v. *Zenith Radio Corp.*, 475 U.S. 574 (1986) is misplaced. In their view, respondents' case was implausible because "the proposition that Kodak has market power in the parts market . . . is inconsistent with the fact that Kodak lacks market power in the equipment market." S.G. Br. at 11. In fact, as the above discussion suggests, the only situation in which it would be implausible to posit aftermarket power in the absence of power at

this is yet another reason why it cannot conclusively be presumed that competition at the equipment level prevents the occurrence of significant anticompetitive behavior in the aftermarkets for parts and service.

D. *Purpose To Foreclose the Market.* In this case, the petitioner intended to drive the independent service organizations from the field through its policy of confining its parts to customers who purchase service from Kodak, save only for those who serviced their own equipment.[15] J.A. 91-92; *see also* J.A. at 22, 426-27, 455, 805. Even if competition for new sales of equipment would prevent a

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the equipment level is in the idealized perfect market. The further one gets from that ideal, the more plausible it becomes.

Furthermore, it is noteworthy that the alleged conspiracy in *Matsushita* involved sales by the conspirators at low prices. It made sense for the Court to encourage summary disposition of such a case in order to avoid prolonged litigation that might deprive consumers of the benefit of low prices. Such considerations hardly apply to this case, in which there is evidence, as the lower court found, that petitioner was charging higher prices for service that was of poorer quality than that provided by the independent service organizations. *Image Technical Servs.*, 903 F.2d at 614.

[15] Tying that does not have an immediate effect on aftermarket prices may nonetheless raise antitrust concerns because of the longer-term effects of market foreclosure, which shuts out competitors and defeats the wishes of purchasers who might, for whatever reason, have preferred to purchase from a different vendor on different terms. Thus, the Court in *Jefferson Parish Hospital* found that even if the tying seller was not working towards a monopoly position in the tied product, " 'the practice of tying forecloses other sellers of the tied product and makes it more difficult for new firms to enter that market.' " 466 U.S. at 12-13 n.19 (quoting *Fortner Enters.* v. *United States Steel Corp.*, 394 U.S. 495, 512-14 (1969) (White, J., dissenting)). Justice O'Connor's concurring opinion in *Jefferson Parish* agreed that one of the major purposes of tying law is "to identify and control those tie-ins that have a demonstrable exclusionary impact in the tied-product market." 466 U.S. at 35 (citing *Times-Picayune Publishing Co.* v. *United States*, 345 U.S. 594, 605 (1953)). As Justice O'Connor also noted, "[t]he antitrust law is properly concerned with tying" when power in the tying market is used to gain additional power in the tied market "by driving out competing sellers." 466 U.S. at 36-37.

manufacturer from engaging in supracompetitive pricing in aftermarkets, it does not follow that such competition would also prevent the manufacturer from engaging in tactics designed to foreclose competitors in the aftermarkets. It may be difficult for a customer of equipment intended to be used for many years to put a price tag on the foreclosure of competitive service providers from the market. As this Court said in *Jefferson Parish Hospital*, 466 U.S. at 15 n.24, "Especially where market imperfections exist, purchasers may not be fully sensitive to the price or quality implications of a tying arrangement . . . ." The manufacturer may be content to have eliminated the customers' option to choose another vendor, or might deem it wise to postpone price increases until well after the independents are driven from the field. By that time, without the independents' prices to provide the customer with a basis for comparison, there may be little reason to expect that the higher aftermarket prices will cause customers to turn to alternative equipment competitors.

These are but illustrative of facts that would tend to disprove a claim that competition for original equipment sales in a particular industry precludes significant anticompetitive behavior in the aftermarket. Some such facts may be specific to particular industries. In the automobile industry, one such fact is that the immediate victims of any action by a manufacturer precluding use of independently-made crash parts for the repair of its automobiles will be the insurance industry and the crash parts manufacturers, which have no power to decide what car the customer should buy.

III. COMPETITION FOR SALE OF NEW AUTOMOBILES DOES NOT PREVENT EXPLOITATION OF PARTS AND SERVICE AFTERMARKETS

Petitioner's argument—that it does not matter what aftermarkets a manufacturer tries to monopolize, so long as it lacks market power over equipment sales, J.A. at

688—simply makes no sense when applied to the automobile repair aftermarket, as the facts set forth below show. Those facts also show that acceptance of petitioner's argument would have serious consequences for automobile insurers and their policyholders, because automobile manufacturers would see such acceptance as a green light to move toward a long-sought objective, the restoration of their monopoly over crash parts.[16]

A. Competition in the Manufacture of Crash Parts Has Resulted in Significantly Lower Parts Costs

Insurance companies have a major stake in a competitive crash parts market. Automobile insurance companies account for most of the approximately $9 billion worth of crash parts purchased annually in the United States.[17] Automobile insurers pay for more than 75% of all such parts sold,[18] which are installed by repair shops that are part of an immense service network for automobile re-

[16] The automobile companies have unsuccessfully tried to secure this objective through legislation. *See Industrial Design Protection: Hearings on H.R. 902, H.R. 3017, and H.R. 3499 Before the Subcomm. on Courts, Intellectual Property, and the Administration of Justice of the House Comm. on the Judiciary*, 101st Cong., 2d Sess. 403-04 (1990) [hereinafter *House Hearings*] (statement of Donald A. Randall, Washington Representative, Automotive Service Association); *see also* James F. Fitzpatrick, *Industrial Design Protection and Competition in Automobile Replacement Parts—Back to Monopoly Profits?*, 19 U. Balt. L. Rev. 233 (Fall 1989/Winter 1990); David Brooks, *The Sheet Metal War*, Nashville Automotive Report, Feb. 1991, at 4.

[17] *House Hearings*, *supra* note 16, at 218 (statement of C.A. Ingham, Vice President and General Counsel, State Farm Mutual Automobile Insurance Company).

[18] Some insurers are the actual purchasers of the parts; others simply pay the repair shop or reimburse the automobile owner for the cost of such parts. There is no substantive difference between these transactions. We use the generic term "purchase" in this brief because that is the economic reality of these transactions, regardless of form.

pairs—over 360,000 establishments generating $27 billion in revenues.[19] Over 90% of the service outlets for automobile repair and maintenance are independent repair shops, service stations, and garages; they account for 75% of the crash repair business. The remainder is performed by franchised automobile dealers.

Until very recently, the automobile manufacturers were the only sources of crash parts. In the early 1980s, others began to produce and sell crash parts for popular makes and models.[20] These competitive parts were offered for sale in the United States at prices below those for the equivalent parts produced and sold by the original equipment manufacturers ("OEMs").[21] Gradually, over the years, more and more competitive crash parts have made their way to the American market for the repair of crash-damaged vehicles. While the effect of these competitive parts on the market for repairs has been dramatic, the insurance company amici estimate that some 25,000 out of a total of 200,000 crash parts, only one of eight, are currently available from independent sources. Thus, the OEMs continue to be the sole source for most crash parts. In almost no case is it possible to repair a crash-damaged vehicle without the use of some OEM parts.

By and large, independent manufacturers of crash parts sell them to independent repair shops. The automobile manufacturers have discouraged their franchised dealers from using competitive crash parts.

The advent in the United States of competitive crash parts has substantially reduced the price of such parts.

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[19] *House Hearings, supra* note 16, at 403, 418 (statement of Donald A. Randall, Washington Representative, Automotive Service Association); *see also* Automotive Parts & Accessories Association, *1991 APAA Aftermarket Fact Book* 6.

[20] *House Hearings, supra* note 16, at 219-20 (statement of C.A. Ingham).

[21] *Id.* at 220.

Studies have shown that between 1970 and 1980, before competition arose, OEMs increased prices for their crash parts at a rate that exceeded inflation.[22] After competition was introduced, the upward trend in prices was halted.[23]

This competition in the crash parts market has not only provided lower-priced alternatives to OEM parts, but has restricted OEMs' pricing freedom with respect to their own parts when there is a competitive alternative. OEM parts prices were reduced in response to the prices of competitive parts, but the prices of competitive parts were reduced to even lower levels. For example, in 1983, Honda charged $151 [24] for a 1980 Accord fender. In 1983, competing manufacturers began to sell fenders for the repair of the 1980 Accord in the U.S. market for $114.[25] Both Honda and the competing manufacturers successively reduced their prices. By 1989, competition had forced Honda to reduce the price of a 1980 Accord fender to $93 [26]—38% below the price in 1983.

In contrast, Honda in 1983 charged $110 for a replacement front door for the same model 1980 Accord and by 1989 increased its price to $159—45% more than the cost of the part in 1983.[27] No independent manufacturer has sold an Accord door in the U.S. market.

As shown in Table 1, *see* Appendix, the development of competition in the manufacture and sale of crash parts

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[22] *Id.* at 220-21. *See also In re General Motors Corp.*, 99 F.T.C. 464, 584 (1982) (finding that automakers had "unfettered pricing discretion" in the repair parts aftermarket).

[23] *House Hearings, supra* note 16, at 769 (submission of Claude Barfield, Director, Trade Policy Studies, American Enterprise Institute (State Farm and Allstate) [hereinafter *Barfield Report*]),

[24] *Id.* at 779.

[25] *Id.*

[26] *Id.*

[27] *Id.*

produced similar savings benefits for the vehicles of virtually all major automobile manufacturers. It is estimated that the existence of competition in the manufacture and sale of crash parts currently saves U.S. automobile insurance companies and their policyholders some $400 million per year,[28] and the savings are growing year by year.[29]

B. The Automobile Industry's Likely Response if Petitioner's Argument Is Accepted Would Be To Eliminate Competition from Independent Crash Parts Manufacturers

Manufacturers of automobiles have historically followed nearly identical policies and practices with respect to the manufacture and distribution of crash parts. If freed by petitioner's proposed rule of all antitrust law constraints in the aftermarket, it must be anticipated that they will all seek to rid themselves of competition in the sale of crash parts by various techniques. For example, each might forbid its franchised dealers from selling OEM parts to independent repair shops unless the latter agreed to install those parts only in conjunction with other OEM parts—*i.e.*, unless the independent repair shops agreed not to use competitively manufactured crash parts in the repair of the manufacturer's cars. The MVMA amicus brief practically says as much. MVMA Br. at 9-10. In

[28] *Barfield Report*, *supra* note 23, at 786. This $400 million figure is a conservative assessment of the savings resulting from the advent of competition in the crash parts market. It reflects only those savings resulting from insurers' use of independently manufactured crash parts. This figure does not include the significant additional savings attributable to OEM reduction of the prices of their own parts to meet the competition. *See* Appendix, Chart I.

[29] Given the magnitude of these savings, it seems bizarre to suggest, as the MVMA does in its brief, that consumers' welfare would be better served by adoption of the petitioner's proposed rule. *See* MVMA Br. at 11, 14. (For discussion of the impact of petitioner's proposed rule on consumers, see *Brief Amicus Curiae of Public Citizen*.)

a possible variation of this tying arrangement, the automobile manufacturers might decide to continue to give a functional discount on prices for OEM parts for the benefit of independent repair shops,[30] but on condition that the latter agree to use these parts only in conjunction with the installation of other OEM parts.[31]

If permitted by this Court's adoption of the rule advanced by petitioner and its amici, such actions by manufacturers to kill aftermarket parts competition are likely to succeed, because most of the 45 million vehicles damaged in accidents each year[32] require replacement of crash parts for which there are no competitive alternatives. If independent repair shops can secure needed OEM parts only by agreeing not to use any independently-made parts in repairing the manufacturer's cars, they will have no practical choice but to submit, thus eliminating the demand for competitive crash parts.[33]

Given the enormous financial incentives involved, one must realistically expect that all MVMA members would follow suit. The result would be the crippling of the independent crash parts business. Competition from those

[30] Some automobile manufacturers, under pressure from the Federal Trade Commission, grant "functional discounts" on prices of parts purchased by their dealers for resale purposes to enable independent repair shops to compete for repair business with the franchised dealers. In effect, the manufacturers grant a discount to franchised dealers on parts the dealer resells to independent repair shops. *In re General Motors Corp.*, 99 F.T.C. at 470.

[31] Similarly, an automobile manufacturer might so condition its warranty on the car's drive train as to force the owner to use OEM parts exclusively, even on parts outside the scope of the warranty—*e.g.*, crash parts.

[32] *House Hearings*, *supra* note 16, at 418 (statement of Donald A. Randall).

[33] Indeed, the MVMA brief suggests that it would be perfectly appropriate for manufacturers to garner the entire repair business for their franchised dealers, in order to increase their profitability. MVMA Br. at 10.

manufacturers now produces hundreds of millions of dollars annually in savings for insurance companies and their policyholders.

C. Consumer Response in the New Car Market Will Not Prevent Manufacturers' Anticompetitive Conduct in the Aftermarket

According to the conceptual argument advanced by petitioner and its amici, the disciplinary effect of sales competition for new cars guarantees that the above scenarios cannot happen. In light of the above facts, that argument lacks economic plausibility.[34]

First, the "disciplinary effect" theory fails because in this industry, as we have shown, those with the greatest incentive to exert such an influence upon automobile manufacturers will be the insurance companies and the independent crash parts producers, which have no power over the policyholder's choice of a car.[35] Conversely, automobile buyers' incentives to discipline manufacturers are reduced to the extent that the buyers expect such costs to be covered by insurance. Thus, aftermarket tactics to foreclose crash parts competitors do not impact on competition in the sale of automobiles. Petitioner's chain of reasoning snaps at its most critical point.

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[34] The British Monopolies and Mergers Commission rejected a similar argument. In their investigation of Ford's policy not to grant licenses to manufacture or sell crash parts for Ford vehicles, the Commission found that "the public interest in competition in the sale of replacement parts is not satisfied merely by the existence of competition between car manufacturers at the point at which a new car is sold." The Monopolies & Mergers Comm'n, *Ford Motor Company Limited* 39 (presented to the U.K. Parliament Feb. 1985) (a report on the policy and practice of Ford Motor Co., Ltd. of not granting licenses to manufacture or sell in the U.K. certain replacement body parts for Ford vehicles).

[35] Some insurance companies charge different premiums for different cars but these reflect many factors, such as differences in prices, frequency of accidents and theft rates, not merely the cost of competitive crash parts.

The plain fact is that insurance companies, rather than automobile owners, are the consumers of crash parts and crash repair services. Accordingly, it is the insurance industry that is chiefly concerned about the cost of crash parts and crash repair services. As a practical matter, of course, the increased repair costs will eventually be borne by all those who carry property damage and physical damage liability insurance, whether or not their cars are ever involved in a collision. Thus, the effect of any particular manufacturer's activities in the aftermarket to foreclose competition from independent crash parts manufacturers will be spread among all automobile owners who have such insurance. The increases in insurance premiums due to costs of crash parts will be diluted and remote in time from the critical automobile purchase decision as to lack any significant disciplinary impact upon the automobile manufacturer.

Second, those in the market for a new car would in any event find it impossible to factor the cost of the destruction of crash parts competition into their purchase decisions.[36] Crash parts represent a huge dollar volume in the aggregate, but constitute only a small percentage of the total replaceable parts on an average automobile. The buyer would have no way of knowing in advance which crash parts of the automobile he or she might need and which are or will be subject to such competition be-

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[36] The MVMA claims that "purchasers of automobiles and trucks, like the purchasers of Kodak copiers, know that replacement parts and service will be required from time to time, and they take this into account when they make their purchase decisions." MVMA Br. at 4. If this is meant to represent that consumers carefully calculate the likely cost of repairs (including crash parts) as well as maintenance and hard parts over the life cycle of the automobiles, we suggest that this defies conventional experience. It is also inconsistent with the FTC's finding in *In re General Motors Corp.*, 99 F.T.C. at 483, that "[a]ccident repair costs are of little, if any, importance to most purchasers buying an automobile since they believe their insurance will cover damage expenses above the deductible amount." At best, consumers have only a generalized concern over, and knowledge of, maintenance and repair costs.

tween the car manufacturer and independents. Nor can the buyer know whether the other driver in an accident will in any event have to pay for the costs.

In short, there is no way that an automobile buyer who may be aware of the manufacturer's actions to destroy the independent crash parts business could have any idea of how much such actions will cost that buyer. Without such consumer awareness, the argument that new sales competition will prevent a manufacturer from adopting such a parts policy simply falls apart. Certainly, in a case challenging such a parts policy, the plaintiff should not be precluded from submitting proof that consumers lack knowledge and that the manufacturer's anticompetitive policies in aftermarkets are therefore unlikely to cause a loss of new equipment sales.

Finally, where will the putative angry buyer turn? Given a green light to engage in any available anticompetitive practice in the aftermarket, it is likely that most major automobile manufacturers will follow the same policy, since all have the same concern over the extent to which the independent crash parts business has cut into their profits.[37] With parallel behavior among OEMs in the aftermarket, any given manufacturer may cheerfully take aim at the independent crash parts makers, confident that this will not cause loss of new car sales. Once again, then, there is no basis for a conclusive presumption that competition for new sales acts as a deterrent upon the manufacturer's aftermarket policies.

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[37] "Many car dealerships rely on parts and service sales for a large part of their profits, especially with car sales down and car manufacturing capacity in this country alone estimated at as many as two million more buildable vehicles than the market can absorb. In short, sheet metal sales and body shop service dollars are keeping many dealerships' front doors open. They can ill afford to lose profit margins because of increased competition from low cost suppliers." Brooks, *supra* note 16, at 4.

For all these reasons, the Court should decline to announce the sweeping rule that petitioner, the Solicitor General, the MVMA and other amici seek. To the contrary, plaintiffs should remain free to demonstrate that, in the factual context of the particular industry involved, a lack of market power over equipment sales does not prevent the manufacturer from engaging in significant anticompetitive conduct in related aftermarkets.

CONCLUSION

The decision of the Court of Appeals should be affirmed.

Respectfully submitted,

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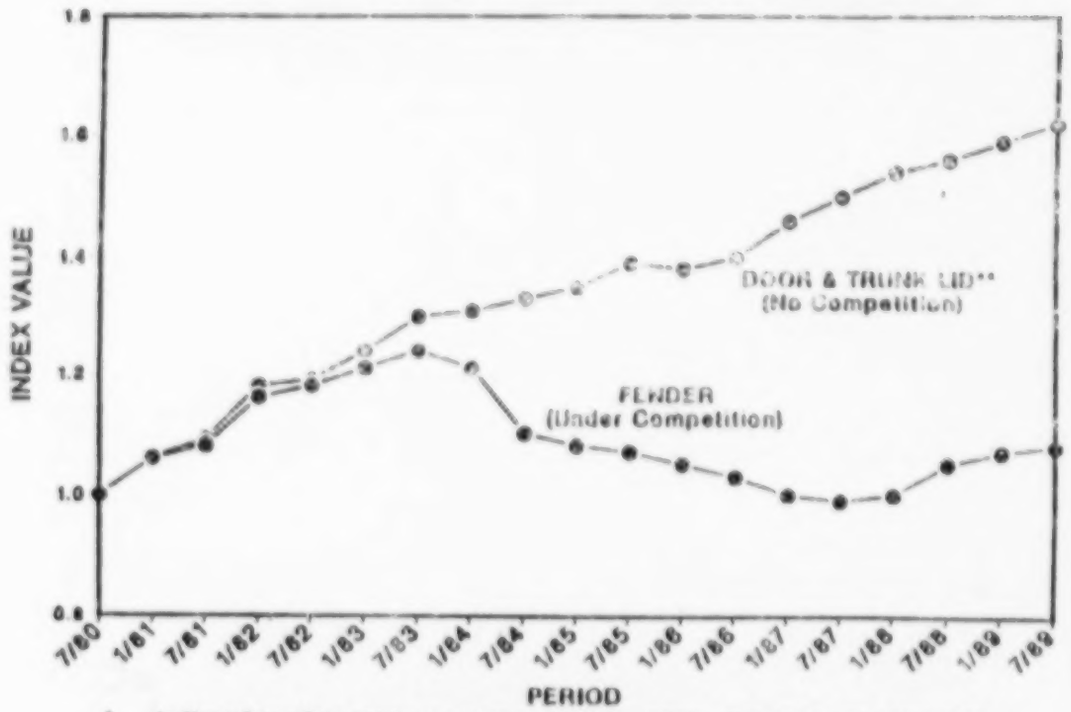
APPENDIX

APPENDIX

Chart I

Reprinted from *Barfield Report*, *supra* note 23, at 776.

INDIVIDUAL CRASH PART PRICES ACROSS MODELS: OEM PARTS UNDER COMPETITION COMPARED TO OEM PARTS NOT UNDER COMPETITION*



* Indices based on thirty-one car and truck models. Existence of competition determined by KEYSTONE CRASH PARTS DIGEST. OEM prices taken from MITCHELL MANUAL & COLLISION ESTIMATING GUIDES.

** Body side panel and tail gate prices were used for trucks.

Source: State Farm Research

Table I

Auto Manufacturer Crash Part Pricing: Impact of Aftermarket Competition
* denotes introduction of competition

Crash Part	Auto Manufacturers' Prices[1]							Competitor Price[2]		% Change in OEM Pricing 1983-1989
	1983	1984	1985	1986	1987	1988	1989	Intro	1989	
FENDER										
1980 Chevette	$ 129*	$ 94	$ 75	$ 71	$ 71	$ 71	$ 71	$ 96	$ 64	-44
1980 Accord	151*	151	75	73	83	86	93	114	80	-38
1981 Escort	82*	64	64	64	63	66	66	70	59	-20
1980 Challenger	181	181	190	190	190	195	195	-	-	8
1980 Corona	141	151	151	151	177	196	196	-	-	39
FRONT DOOR[3]										
1980 Chevette	81	90	90	90	95	95	98	-	-	20
1980 Accord	110	115	115	130	142	146	159	-	-	45
1981 Escort	274	283	312	312	326	341	374	-	-	36
1980 Challenger	368	368	386	386	386	386	400	-	-	9
1980 Corona	220	242	254	255	276	312	327	-	-	49
TRUNK LID[4]										
1980 Chevette	196	198	198	198	220	220	231	-	-	17
1980 Accord	134	140	140	160	181	188	207	-	-	54
1981 Escort	207	214	214	214	224	236	245	-	-	18
1980 Challenger	162	162	170	170	170	170	175	-	-	8
1980 Corona	229	216	257	291	341	380	380	-	-	66

Auto Manufacturer Crash Part Pricing: Impact of Aftermarket Competition
* denotes introduction of competition

Crash Part	Auto Manufacturers' Prices[1]							Competitor Price[2]		% Change in OEM Pricing 1983 - 1989
	1983	1984	1985	1986	1987	1988	1989	Intro	1989	
GRILLE										
1980 Chevette	$ 65	$ 67*	$ 45	$ 43	$ 43	$ 43	$ 43	$ 50	$ 38	-34
1980 Accord	112*	112	54	54	60	62	67	70	58	-40
1981 Escort	60	62	48*	47	47	45	45	52	39	-25
1980 Challenger	211	211	222	222	229	244	248	-	-	18
1980 Corona	68	68	79	79	91	100	95	-	-	40
HOOD										
1980 Chevette	224	231*	161	154	154	154	154	168	111	-31
1980 Accord	140	140	140	136	161	174	189	-	-	35
1981 Escort	208	215*	182	161	161	149	149	160	128	-28
1980 Challenger	222	222	222	222	222	227	235	-	-	6
1980 Corona	162	179	180	181	212	235	235	-	-	45

Source: State Farm Research

* Competition introduced in 1982
[1] Prices are taken from Mitchell's Manuals Collision Estimating Guides.
[2] Prices from Keystone Crash Parts Digest.
[3] Right door of 2-door model selected. If 2-door model not available, right front door of 4-door model was selected.
[4] Hatchback price selected if trunk lid not available.

Reprinted from *Barfield Report, supra* note 23, at 779-80.